



No. 64

April 26, 2004

S. 150 – Internet Tax Nondiscrimination Act

Calendar No. 353

Reported by the Commerce Committee on September 29, 2003, by voice vote with an amendment in the nature of a substitute. S. Rept. 108-155. The bill then was sent to the Finance Committee and discharged on October 29, and it was placed on the Senate Calendar.

NOTEWORTHY

- By unanimous consent, the Senate will resume consideration of the motion to proceed to S. 150 at 2 p.m. today, and will vote on cloture on the motion to proceed at 5:30 p.m.
- The Internet Tax Freedom Act (ITFA) was signed into law on October 21, 1998, imposing a three-year moratorium on state- and local-government taxes on Internet access, as well as on any multiple or discriminatory state and local taxes on Internet-based transactions.
- In 2001, Congress approved the Internet Tax Nondiscrimination Act (H.R. 1552, 107th Congress), which amended the ITFA by extending the tax moratorium through November 1, 2003.
- The House of Representatives approved its version of the Internet Tax Nondiscrimination Act, H.R. 49, by voice vote on September 17, 2003, and the Senate began consideration of a related bill, S. 150, on November 6, 2003. However, after two days of debate during which time the Senate agreed to a McCain substitute (S. Amdt. No. 2136), the bill was returned to the Calendar.
- This Legislative Notice describes the McCain substitute adopted in November (Amdt. No. 2136). The bill's main provisions include: a permanent extension of the moratorium on state and local Internet-access taxes and on state and local multiple or discriminatory taxes on e-commerce; modifications to the definitions of "Internet access" and "Internet access service"; and an extension of the current grandfathering provision under the ITFA.

Background

The Internet Tax Freedom Act (ITFA) was signed into law on October 21, 1998 (Public Law 105-277; included as titles XI and XII of the Omnibus Appropriations Act of 1998). It imposed a three-year moratorium on state and local government taxes on Internet access. In addition, the same three-year moratorium also applied to any multiple or discriminatory state and local taxes on Internet-based transactions (e.g., sales taxes on Internet purchases from an out-of-state vendor with no nexus to the purchaser's state of residence).

In 2001, Congress voted to amend the ITFA by extending the tax moratorium through November 1, 2003, under the Internet Tax Nondiscrimination Act (H.R. 1552), which was enacted on November 28, 2001 (Public Law 107-75). Because no subsequent legislation has been enacted, the moratorium expired on November 1, 2003.

On July 16, 2003, the Commerce Committee held a hearing on S. 150, introduced by Senator Allen, and S. 52, introduced by Senator Wyden, concerning the extension of the Internet tax moratorium. On July 31, 2003, the committee held an executive session to consider S. 150, and ordered the bill reported by voice vote with an amendment in the nature of a substitute.

On September 17, 2003, the House of Representatives approved by voice vote a related bill, H.R. 49, the "Internet Tax Nondiscrimination Act," which would extend permanently the moratorium on Internet-access taxes and on discriminatory and multiple taxes on e-commerce transactions.

The Senate began consideration of S. 150 on November 6, 2003. After two days of debate (and no roll call votes), the bill was returned to the Calendar. During the debate, Senator McCain offered a substitute, Amendment No. 2136, which was adopted by voice vote.

Bill Provisions

When S. 150 was considered by the Senate in November 2003, Senator McCain proposed an amendment in the nature of a substitute (Amendment No. 2136). Since the McCain substitute is still the pending business with respect to the bill, its provisions are described below. (A description of the bill's provisions, the committee-reported substitute amendment, and revenue estimates can be found in the Commerce Committee's report, Senate Report 108-155.) Note, however, that it is anticipated that Senator McCain will offer a new substitute on the floor this week. [See pp. 4-5 for details.]

Amendment No. 2136 would extend permanently the expired Federal moratorium on state and local Internet-access taxes and on state and local multiple or discriminatory taxes on e-commerce.

The amendment, however, would narrow the scope of the moratorium and make certain clarifications about its effect. Specifically, it would modify the definitions of “Internet access” and “Internet access service” contained in the ITFA to provide that such terms do not include telecommunications services, except to the extent such services are used to provide Internet access. Notably, the modified definition would not affect the taxability of voice telephony over the public switched telephone network (referred to as “plain old telephone service” or “POTS”).

The amendment would also extend by three years the current grandfathering provision, which permits states that imposed or enforced a tax on Internet access prior to October 1, 1998 to continue taxing Internet access. After October 1, 2006, the grandfathering protection would be eliminated.

The amendment also makes clear that the moratorium does not preclude state and local governments from imposing non-Internet-access taxes, such as those based on net income, capital stock, net worth, or property value.

Amendment No. 2136 also provides that if Internet-access charges are bundled with other taxable telecommunication services without a cost breakdown, the Internet-access charges may be taxed unless the Internet service provider can reasonably identify the charges for Internet access from its regular books and records.

Finally, the amendment reaffirms that nothing in the ITFA shall prevent state and local governments from regulating Internet access or from imposing or collecting any fees or charges used to preserve and advance universal service or similar state programs (e.g., 911 services) authorized by section 254 of the Communications Act of 1934.

Cost

According to the Congressional Budget Office’s (CBO) cost estimate included in the committee’s report, the provisions of S. 150 will have no impact on the federal budget. The CBO estimates, however, that beginning in 2007, the bill as reported would likely cost grandfathered state and local governments an aggregate annual amount of between \$80 million and \$120 million. Because Amendment No. 2136 addresses the POTS issue, discussed above, it is anticipated that the cost to grandfathered state and local governments would decline.

Administration Position

On November 6, 2003, the Administration released a Statement of Administration Policy (SAP), which stated the Administration “strongly supports” passage of S. 150. The entire statement reads as follows:

The Administration strongly supports passage of S. 150 to make permanent the moratorium on taxes on Internet access, regardless of the speed of that access, and on multiple or discriminatory taxes on electronic commerce. The Administration believes that government should support e-commerce and Internet usage and availability, including the use of broadband technology, and not discourage it through new administrative barriers or taxes. The Administration urges the Senate to pass S. 150 expeditiously so that the moratorium can be made permanent.

Other Views

Senators Alexander and Carper have introduced a competing proposal to address the expired Internet-tax moratorium. Their bill, the “Internet Tax Ban Extension and Improvement Act,” S. 2084, provides a two-year extension of the ITFA’s moratorium on Internet-access taxes and on multiple and discriminatory states on e-commerce transactions. In addition, the bill modifies the grandfather rule under the ITFA to exempt taxes on Internet access that were generally imposed and actually enforced by a state or local government as of November 1, 2003, including taxes imposed on Digital Subscriber Lines (DSL).

The Internet Tax Ban Extension and Improvement Act also modifies the definition of “Internet access” and “Internet access service” under the ITFA by replacing the exclusion of telecommunications services with the following new provision: Such terms do not “include telecommunications services, except to the extent such services are purchased, used, or sold by an Internet access provider to connect a purchaser of Internet access to the Internet access provider.” These provisions are generally described as exempting from tax the “last mile” of Internet access between the Internet service provider and the customer.

Finally, as in the pending substitute amendment to S. 150, the Alexander-Carper bill provides that bundled Internet-access charges may be taxed unless they can be separately identified, and S. 2084 reaffirms that nothing in the ITFA shall affect state and local regulation of Internet access or imposition of fees or charges with respect to the current universal service or similar state programs authorized by section 254 of the Communications Act of 1934.

Possible Amendments

- McCain Compromise Amendment: Senator McCain is expected to offer a substitute amendment that would:
 - provide a temporary four-year moratorium (until October 1, 2007) on state- and local-government taxes on Internet access, as well as on any multiple or discriminatory state and local taxes on Internet-based transactions;

- modify the definition of “Internet access” to exclude traditional telephone service and carve out Voice over Internet Protocol (VOIP) to the extent that such service mirrors traditional telephone service;
 - narrow the definition of “Internet access” by carving out voice and other services provided over the Internet, while ensuring that services incidental to Internet access (like e-mail and instant messaging) remain tax-free;
 - grandfather for three years (until October 1, 2006) states that imposed or enforced a tax on Internet access prior to October 1, 1998;
 - grandfather for two years (until October 1, 2005) states that currently tax Internet access (including those that tax the “last mile”), but that were not protected by the ITFA grandfather clause;
 - Incorporate all other common components of Amendment No. 2136 and S. 2084 (i.e., the provision relating to bundling of Internet-access charges, the exclusion of non-Internet-access taxes from the moratorium, and the provisions concerning state and local regulation of Internet access and imposition of fees or charges with regard to universal service and 911 services).
- Alexander-Carper Alternative: Senators Alexander and Carper are expected to offer their alternative language (S. 2084, described on p. 4) as a substitute amendment to the bill.